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# South Asia

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## India's road to glory strewn with potholes

Kunal Kumar Kundu

Indian business leaders are much more optimistic about the future than their international peers. They may have good reason for optimism as a report by the global consultancy firm KPMG suggests India is moving in the right direction, though there are still hurdles to overcome.

A recent global survey by McKinsey consultants suggests executives in India think that the opening up of the global economy presents them with huge opportunities for growth.

The survey, which polled more than 9,300 executives around the world, including 537 in India, indicated that about 88% of Indian executives believe that continued economic liberalization is vital to the future of global business. Even more think the by-products of liberalization - increasing affluence in emerging economies and the proliferation of low-cost manufacturing options - will be important global business trends.

Indian executives see their best growth prospects in the home market - 58% of them expect India to provide most of their companies' sales growth during the next five years.

That India is a bustling market and an important growth center for the global economy is well espoused by Thierry Cros, managing director of Seco Tools India. According to him, "Earlier, [India] was a reward posting for those who were close to retirement." He added that "These senior people would spend their time playing golf and they would run the company as it would have been run in Europe [read: expensively] and the parent was not too concerned if the India operations did not deliver any cost advantage. Now, younger managers in their 30s and 40s are coming out. For us, it's important we show results. If we don't, there's a return ticket."

The big shift in the expat profile has another implication: now, they tend to stay longer. "The senior people stayed three years at the most," Cros said. "Now, MNCs [multinational corporations] want in-depth understanding of the market and the culture. This is built up over a longer period of time so we now have longer tenures."

Prior to coming to India, Cros had worked in his native France and in Germany, and he recalls his first trip to India as a big shock. "But lots has changed in the six years we have been here," he said. "The gap between India and Europe has narrowed and this is to be found in the business environment too."

Not surprisingly, according to a survey by global consultancy firm KPMG, India has emerged as a key foreign direct investment (FDI) destination as foreign investors earn higher returns in India than in other emerging markets.

According to the report, India represents an economic opportunity on a massive scale: China and India are likely to be the world's two biggest economies by mid-century, and although India has underperformed in the first lap of the growth race, there was a strong possibility that India may well move ahead.

Although India is still seen by industrial investors as an economy where risk is higher and the business environment more problematic than in rival Asian investment locations, India also offers some advantages in the region. The legal framework that protects investment is one of the best in Asia. The economy offers an abundance of technical and managerial talent, often with international experience.

Geopolitical risk is diminishing consistently, in contrast with some of India's emerging economic rivals in Asia. And above all, India has a demographic advantage that should see its working-age population continue to grow well into the century, increasing wealth and reducing cost.

However, infrastructure bottlenecks are hindering larger FDI inflow in India when compared to countries such as China. "India may need to make more rapid improvements in its business infrastructure if it is to continue to attract foreign investment in the face of growing competition from China, which it outperforms in many areas including return on investment," KPMG said in its report entitled Manufacturing in India.

Leaving aside infrastructure, KPMG said India scores over other Asian nations in terms of legal framework, availability of natural resources, pool of technical and managerial talents and the demographic advantage of a large young population.

"The return on every dollar spent in India has a better return than is the case with other emerging markets that have a more favorable environment," the report said. While compiling the report, KPMG India managing director Ian Gomes said, "It quickly became clear just how many advantages India has over other developing economies like China, Brazil and Mexico."

According to the report, the Indian central government has succeeded in opening many sectors of the economy to foreign investment, while reserving others to state or local business. These continuing restrictions impose costs on manufacturers even though many manufacturing sectors (apart from strategic industries such as defense and aerospace) are open for investment.

According to the World Bank, the burden of licensing and bureaucratic administration has significantly reduced since 2000. In terms of companies' perception of the burden, India scores better than either China or Brazil on business regulation, better than either on the burden of tax and customs administration and better than Brazil on the perceived level of corruption.

Indeed, India has changed, and changed fast. "If you had asked me 15 years ago I would have said there was no hope for India, economically," said Kuldip Khushoo, head of manufacturing at Honeywell Automation India. "There were so many regulations and restrictions, it was enough to send anyone crazy. But now there has been a sea change, a real opening of the economy."

Nevertheless, the road to glory is still strewn with potholes which, if it remains unattended, can make the journey painstakingly slow. According to the KPMG survey, what holds back the investors, more than anything else, it is the quality of government and administration.

First, there are doubts about the commitment of successive governments to deliver rapid reform in what many agree is one of the most regulated and bureaucratic of the emerging economies. The reform process began under the Congress party at the start of the 1980s, passed into the hands of the nationalist Bharatiya Janata Party (BJP) government in the 1990s, and then back into today's Congress-dominated coalition government after the general election of 2004.

Both Congress and the BJP proclaim the cause of reform - actually dismantling India's countless licenses, charges and administrative barriers to business is another matter entirely. And a significant part of India's labor cost advantage is cancelled by the excessive bureaucratic cost of doing business. After all, India spent the first four decades of independence trying to limit the influence of foreign capital in the economy. Those attitudes die hard. When Indian Finance Minister P Chidambaram presented the budget this year, he still had to ask parliament's indulgence for the fact the federal government wanted to encourage foreign investment.

That apart, the most important constraint continues to be the state of physical infrastructure. According to the McKinsey survey, 60% of the respondents in India regard inadequate infrastructure as a significant or very significant constraint on growth, a view shared by only 23% of the global panel.

Also, rather surprisingly, for a country with one of the world's largest labor pools, the Indian executives see the high cost and low availability of talent as the single greatest constraint on their companies - a problem that worries them much more than it does their counterparts around the world.

With a relatively young population of 1.1 billion people, India has a vast reserve of workers, but the Indian respondents to the McKinsey survey say that finding the right ones will be difficult. Indeed, 81% of them (as compared with 73% of the global panel) opined that the cost and availability of talent will be a significant constraint on business over the next five years. Indian IT executives feel this kind of pressure more keenly than do their counterparts in other sectors: 91% of them say that it is a significant constraint on the growth of their companies. These views may reflect the rising cost of IT, engineering and management employees in hotbeds of growth such as Bangalore, Hyderabad and Mumbai.

Corruption is also an important cost, though not as debilitating. What concerns investors more are inflexible labor laws that make it difficult for the corporates to ramp up during economic upswing, since they are afraid of being stuck with excess labor when when the curve slides.

However, while the task for the Indian policy makers is onerous, respondents to the KPMG survey agree that, whatever the faults in execution, they are moving in the right direction.

Also, as awareness of India's potential grows, so should the understanding of the business case for manufacturing investment in India. Some companies point out that actual returns from Indian investment compare very favorably with returns from emerging economies where the environment may not appear quite so challenging.

"What has the invested dollar returned to us in India, compared to say China?" asked Pradipta Sen of Emerson India. "We have been in India for 25 years and 17 years in China. Every dollar we have put into India has earned a very good return. Every dollar invested in China promises a terrific return, but it is still only a promise. Investing in India is justified in terms of a solid historical business case."

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